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A review by the Federal Reserve Bank of Chicago

Business Conditions

1957 May



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THE Trend OF BUSINESS

Several important measures of activity which had coursed upward during most of 1956 have maintained a remarkably level trend in recent months. Factory and mine output, in total, changed little from October through March. Retail trade, seasonally adjusted, was maintained near the level reached in November. Moreover, total spending represented by the gross national product increased only slightly in the first quarter.

Past patterns of economic trends provide few illustrations of such plateaus. As the year moves on, it is highly probable that the recent leveling will appear to be either the "pause that refreshes" before renewed real growth which must be reasserted in time or the prelude to some temporary slide in over-all activity.

Examination of recent trends can never produce sure-fire guides to the future. But the apparent absence of physical gains, as opposed to dollar increases, in late 1956 and early 1957 does not appear to provide as solid a basis for pessimism as the trends which were evident a year ago at this time.

The contrast with early '56

In the spring of last year voices were raised to support the view that the American economy was slipping back from the peaks registered at the end of 1955. The industrial production index dropped from 144 in December to 141 in March (1947-49=100) mainly because of a sharp cutback in the automotive sector. Also there was weakness in textiles and some other lines.

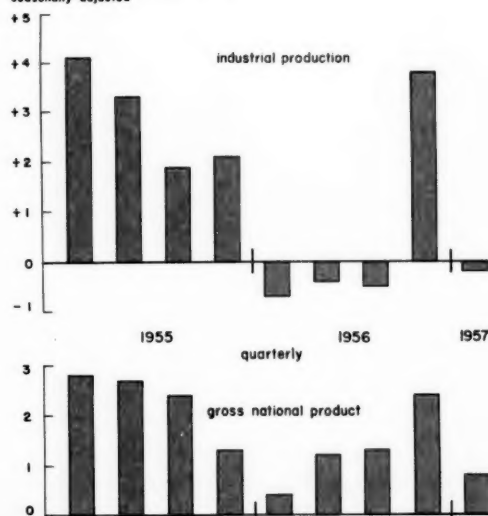
This year auto sales are deemed to be somewhat disappointing, and vehicle output has declined from earlier peaks almost as sharply as a year ago. Despite cutbacks in autos, TV,

appliances and steel, however, industrial production over-all in March was only one point below the December peak. These declines were largely offset by advances in the output of minerals, business equipment and ordnance.

The steel industry had been operating at 98 per cent of capacity in February. In succeeding weeks the rate dropped to about 91 per cent in late March. At this level of operations, it is believed that output approximately balances usage. However, certain firms are still operating their facilities at virtual capacity. Industry experts continue to expect pourings of steel during 1957 as a whole to approximate or exceed

Broad activity measures repeat early 1956 slowdown

per cent change from previous quarter
seasonally adjusted



the 115 million ton total of 1956 which was only a shade below record 1955.

Housing, trade and inventories

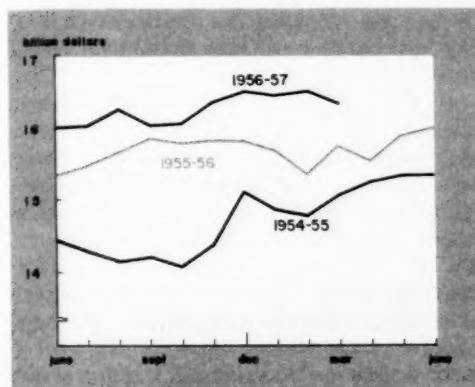
The decline in housing starts was another danger signal a year ago. In March of 1956, new starts were off more than 20 per cent, on an annual rate basis, from the high of 1955. In February and March 1957, the rate of private housing starts dropped below one million for the first time since 1951 and was about 20 per cent below the high of last year. New home building, then, in contrast to industrial production is constituting a drag on total activity much as it did last year.

Retail trade has been well maintained in the early months of 1957 in contrast to a pronounced sluggishness in the same months of 1956. Sales had remained stable in the final quarter of 1955 and had actually dropped off in the first quarter of last year despite rising incomes. Retail trade during March of this year was influenced adversely by the later date of Easter, April 21 compared with April 1 in 1956. Therefore, an adequate comparison requires that March and April be combined. On this basis, preliminary evidence suggests that retail spending has been fairly well in line with the 6 per cent increase in personal income.

Gross national product apparently rose by only 3 billion dollars, or less than 1 per cent, during the first quarter of 1957, despite some uptrend in prices of finished goods. This performance contrasts with a rise of 10 billion dollars in the previous three-month period. However, a similar slowing had been evident a year ago. Between the fourth quarter of 1955 and the first quarter of 1956, GNP rose only 1.5 billion dollars, a development which compared unfavorably with the earlier rate of growth.

In January total business inventories, seasonally adjusted, increased at a rate of 200 million dollars per month. All of this growth occurred at the manufacturing level. During these months last year, inventories were rising by over 600 million dollars a month, or three times as fast. Moreover, wholesale and retail firms were contributing to the rise in early 1956. On the basis

Retail sales on new high plateau



of this comparison, it appears that the current level of business activity owes comparatively little to investment in inventory, an inherently unstable source of demand for goods.

Securities vs. loans

In early 1956, demand on the part of business firms for both long- and short-term funds was very strong. The increase in outstanding securities and bank loans combined was far greater than ever before. This year, some observers have been pointing to the much slower increase in commercial bank loans as evidence of a reduced tempo of business activity.

During the first quarter of 1957, commercial and industrial loans at weekly reporting banks rose only 150 million dollars compared with an increase of about 1.2 billion in the same period of 1956. However, corporate security issues for new capital amounted to 3.3 billion dollars. This was 1.2 billion or 60 per cent more than last year's record. Thus, the greater volume of funds obtained by business from the capital markets about balanced the much smaller increase in loans. Lesser dependence upon short-term financing, of course, suggests an amelioration in the liquidity position of corporate business which had deteriorated substantially during 1956.

Our American economy: strength of the Republic*

In inviting me to address this golden anniversary meeting of the Economic Club of New York, you are according an honor to the great American institution I am privileged to serve. It is deeply appreciated. Unless the Federal Reserve System has the interest and understanding of organizations such as yours, it cannot hope to fulfill its mission.

In seeking understanding I am not asking approval. It is not idle flattery to say that this is a highly enlightened audience, one unusually well-informed in economic affairs. Yet, I dare say, you are by no means unanimous in your feelings about that misnomer, so-called "tight money." If it gets any tighter, as one commentator has amusingly said, it may be just as hard to get into debt as it is to get out.

I shall touch on that subject later, but an occasion such as this invites a broad look at our economic heritage in order that we may take some bearings on the course we are pursuing.

One of the determinants of that course over the sweep of American history has been the position we as a nation have taken, through our democratic processes, on the role and responsibilities of the Government in economic affairs.

Fifty years ago the United States was just completing its transition from a predominantly agricultural country to the leading manufacturing and industrial nation of the world.

Jefferson's belief that Government is best when it governs least was little by little encroached upon. Yet the system we developed, with its main emphasis on the dignity of man's own initiative and enterprise, spurred the transformation of this country from a wilderness to the world's foremost industrial nation at a speed unprecedented in history.

The system worked. That was proved by the mighty surges of expansion. But progress was

not smooth or painless. Prosperity came only in fits and starts. Exhilarating bursts of expansion produced in their wake depressing spells of contraction. Men began to question whether the merriment was worth the misery, especially when the misery was worst among millions who had never gotten in on the merry-making.

Early in the Twentieth Century an event occurred to convert the public's increasingly questioning attitude into a conviction that the Government had a responsibility — a duty — to do something to protect people from economic disasters that were beyond individual control. That event was the Money Panic of 1907. It was into that crisis that the Economic Club of New York was born and out of it that the Federal Reserve System emerged as an institutional response to public demand for the protection I cited.

Diagnosing the panic of 1907 is easy for us now. With the perfect vision of those who look backward in time, we can now readily perceive the panic's approach. We know now that the wave of speculative activity that preceded and provoked it was, in fact, unhealthy.

If the vision of the time was blurred, the reason lay, in part, in the widespread belief that a panic like that of 1893 or 1873 could never again occur. How could it, asked a magazine of the day, in view of the "phenomenal increase of our economic strength, the coordination of American industry since 1899, the establishment of the gold standard of currency and, more particularly, the great and concentrated resources of our banks?"

Certainly most people were caught by surprise when the panic struck. That is evident in

*Address of William McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, before the Economic Club of New York, March 12, 1957.

a picture of the time, sketched by Senator Nelson W. Aldrich in a speech to members of this club two years later. Senator Aldrich, who headed the National Monetary Commission that was established to study the causes of the financial crisis of 1907, told the members of your club, on November 29, 1909, that "to the great majority of the people of the country the blow came without warning." Most of the economic crises in our history have similarly come — which should teach us to beware of smugness or complacency.

By the time Woodrow Wilson took office as President in 1913, financial reform had become a matter of urgent priority. "It is absolutely imperative," the new President said in a special message he delivered before the Congress of June 23, 1913, "that we should give the businessmen of this country a banking and currency system by means of which they can make use of freedom of enterprise and of individual initiative. . . ."

Six months later, Congress responded by passing the Act creating the Federal Reserve System, entrusting to it responsibility for managing the money supply of the country. This was a revolutionary step, signifying an end to the historic refusal of the American people to accept the very real hazards of a managed currency.

It was a careful step, too. In framing the Federal Reserve Act, great care was taken to safeguard this money management from improper interference by either private or political interests. That is the importance of maintaining the System's independence. Hence, we have a system of regional banks headed by a coordinating board in Washington intended to have only that degree of centralized authority required to discharge a national policy effectively. This constitutes, as you know, a blending of public and private interests so uniquely American in character.

Since the Federal Reserve System came into being, the country has not suffered from inelasticity of currency and credit, from immobility of bank reserves or from the money panics that haunted the past. However, we learned

from the inflationary bubble following World War I, and the speculative collapse of the late Twenties and early Thirties, that elimination of these factors of instability did not prevent drastic depression. The over-all problem of stability also involves fiscal, budgetary and debt management policies as well as prudent decisions on the part of the business and financial community.

In the sphere of business and economics, the great challenge of our times is to prevent the recurrence of the boom and crash sequence that has imperiled us in the past, and could destroy us in the future. It is a continuing challenge. Meeting it requires constant vigilance.

Over the last hundred years the American economy has experienced some 24 full turns of the business cycle, an average of one complete rise-and-fall each four years. As a general rule, the immediate impetus to expansion of the Government's role in economic affairs has come from one of these periodic disasters. But sometimes, it appears, we can be driven as hard by fear of disaster as by disaster itself. To find an example, we need go back little more than a decade, to the enactment of the Employment Act of 1946.

In that instance, so great were the psychological scars of the 1930's that the fear that mass unemployment would develop in the wake of World War II was sufficient — though the fear proved groundless — to bring about the Employment Act of 1946, pledging the Federal Government to do its utmost to keep employment, production and purchasing power at consistently high levels.

In 1945, as all of us will recall, there was great apprehension that the problem we were going to face, when the war was over and when millions of men took off their uniforms, would be unemployment on a huge scale, and on all sides, because private business would be unequal to providing jobs for these men.

The same apprehension pervaded Congressional debate on the Employment Act in 1946. The Act was adopted almost unanimously amidst a virtual unity of opinion that it would be necessary for the Government to act to

create jobs and to see that the transition from military to civilian employment would not be attended by unemployment on the scale suffered in the depression.

Actually, the history of the period since the war has made clear that the problem has not been one of creating jobs. The ingredients for growth, the technological advances, the opportunities for development in the entire Western world, in the period since the war, have been limitless — and in my judgment still are. The real problem has been sustaining jobs and holding back inflation that would endanger those jobs by undermining stability.

Nearly everyone subscribes to the objectives of the Employment Act, but it does seem that we need to give more attention to certain related questions: What is the means of attaining high levels of employment? What is the means of sustaining jobs and leading us to a permanently higher standard of living?

In public discussion in connection with the Employment Act, you find many references to money as a medium of exchange, but almost none with respect to money as a standard of value. The reason is that almost all attention was focused on the problem of deflation, and almost none on inflation.

In my judgment, the objectives of the Employment Act of 1946, under present conditions, can be attained only by understanding inflation and resisting it. The fight against deflation begins with the fight against inflation. If inflation is allowed to pursue its course, it feeds upon itself in such a way that, when the inevitable correction finally comes, unemployment will be that much worse.

It should not be difficult to see how inflation leads to unemployment. The danger becomes manifest when, as costs go up, it becomes increasingly hard to pass those costs along to the customer in the form of price increases and it becomes increasingly easy to misjudge or miscalculate the market. Then, the first time volume dips there is a price-profit squeeze and, at some point, the profit squeeze leads to a cutback in investment, income and production. The cut-

back in production leads to a cutback in employment.

That's the cycle. It is what follows when people try to spend more than they have to obtain more goods and services than are currently available. The situation can't be cured by additions to the money supply. More money only pushes up prices and speeds the cyclical effect.

I have less faith in the magic of money and credit than some people, and more faith in the economy than those same people when it comes to recognizing the economy's capacity for adjustment. In the last ten years we have consistently tended to underestimate the vitality and strength of our economy.

Not long ago an economic historian, Robert Heilbroner, declared that man has found, over the centuries, only three ways of insuring the execution of the thousands of intertwined tasks — the disagreeable ones as well as the pleasant ones — that must be done each day to keep human society from breaking down.

One way has been to organize society around the forces of tradition, by handing down the varied and necessary tasks from generation to generation according to custom and usage; son follows father, and a pattern is preserved. Thus, in India, until recently, certain occupations were traditionally assigned by caste.

The second way, also in use for countless centuries, has been to use the lash of central authoritarian rule to see that the necessary tasks get done. That was the system used to build the pyramids of ancient Egypt. It is the system the Soviet government uses today to get its Five Year Plans carried out.

The third solution to the problem of economic survival is the market system. It achieved general acceptance only a couple of centuries ago, and yet it revolutionized civilization in the Western world.

A market provides a means of exchanging goods, but a market system does considerably more. It provides a mechanism for sustaining and maintaining an entire society. It constitutes a way of life that affords freedom that cannot

—continued on page 14

Savings levels and turnover

Savings deposits at Midwest banks are moving back into the limelight. By year-end 1956, savings balances at commercial banks in the District's 32 major cities had grown to nearly 6½ billion dollars, for a gain of 3 per cent from the previous year. But activity in these accounts also has been on the rise, adding to the volume of bank operations in the current period of rising costs. Hence, attention is being focused more and more on the step-up in activity and the factors behind it.

Account size and activity

The total of savings deposits at any bank is made up of accounts of all shapes and sizes. When rates of inflow and withdrawal are to be compared, the particular distribution of account sizes within a bank or for all banks within a city becomes more pertinent than the actual dollar volume of balances. For account size varies a good deal from bank to bank and community to community, and it is associated rather closely with the behavior of savings deposits.

A look at average balances among Chicago banks illustrates the extent to which size of savings account typically varies among the faster-growing and the older, more established sections of a large metropolitan area. In a continuing study of deposit trends in Midwest cities, the figures for the Chicago area, because of its large size and diversity, have been divided into 15 sub-areas. The primary basis for defining these sub-areas has been to group together banks which tend to serve approximately the same kinds of depositors.

The average size of savings account in Loop banks was more than twice that of banks in some suburban areas. Among the various communities outside the city, variations in average account size were almost as striking. Banks in the North Shore section showed average balances 1½ times the size of those in Du Page and southern Cook Counties. Average size of

savings deposit in each of these sections as of January 31 is listed below:

Chicago:

Loop	\$1,499
North Side	1,330
Northwest Side	1,235
South Side	1,005
Southwest Side	1,140
West Side	1,211

Outside the city:

North Shore	1,105
Other North and Northwest	808
Southeast (Indiana)	803
Southern Cook County	685
Far Southwest	1,068
Cicero-Berwyn	952
Other Western Cook County	947
Du Page County	720
Fox River Valley	876

Over-all area average

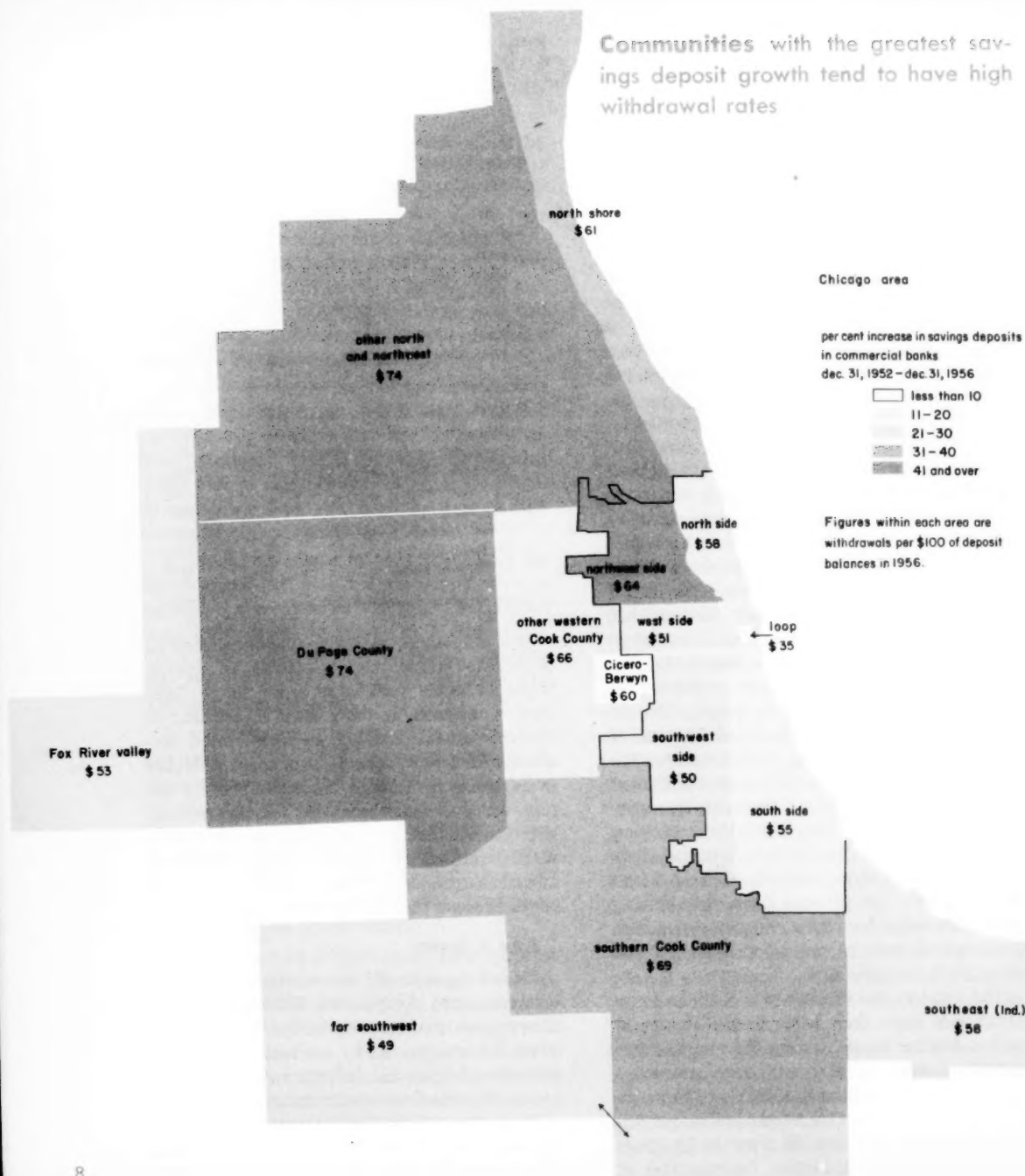
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Size differences in savings balances tend to be reflected in measures of activity. In general, larger accounts turn over more slowly than smaller accounts. In the present comparison of Chicago banks, those banks with a high percentage of large accounts and hence a higher average size of account tended to show a less rapid turnover than those with a smaller average size. Loop banks, for example, had an annual withdrawal rate of \$35 per \$100 of beginning-of-month balances, or less than half that of banks in some outlying communities.

Age a factor

Size of account, of course, is not the only factor involved in explaining differences in rates of savings turnover among banks. While quantitative information is not available to measure precisely the possible influence of age of account on withdrawal activity, there is some evidence that this factor also may be important. The high rate of turnover characteristic of newly opened accounts is all too familiar to most

Communities with the greatest savings deposit growth tend to have high withdrawal rates



bankers. Confirming this tendency, sections of the Chicago area which have had the greatest relative growth in population and apparently in savings deposits as well have shown relatively high withdrawal rates in savings deposits. Among these sub-areas, high inflow rates almost invariably were associated with high withdrawal rates during both 1955 and 1956. This second factor of age of accounts, although closely related to account size, may explain some differences not accountable on the basis of size alone. Thus, banks in older, more established places like Gary, Indiana, and other southeast communities show less withdrawal activity than banks in faster-growing regions northwest of the city, where average size of accounts was about the same.

At best, a substantial part of intercommunity and interbank differences remain unexplained. The kind of community, its income level, al-

ternative outlets for savings funds, prevailing rates paid on savings deposits and other factors which defy precise measurement, all have a bearing upon the behavior of savings depositors in a given area.

Among the individual banks, the attention directed toward the depositor who uses his savings account as a sugar bowl varies a great deal. In some banks, too frequent withdrawals by holders of savings accounts are likely to bring an invitation to shift to a checking account arrangement. Another device to limit withdrawals is the practice of omitting interest payments during a period when excessive withdrawals are made. Finally, some banks make activity charges based upon the number of withdrawals. The course of action of each bank varies as the rising costs associated with turnover of accounts are weighed with considerations of maintaining good customer relations.

Credit unions: mutual finance

As the number of consumers who use credit for durables has increased and experience of lenders with credit-worthy characteristics of individuals has expanded, the use of credit for a variety of personal exigencies and outsized purchases has grown tremendously. Lending to consumers has become a big business with its own "know-how" and peculiar problems.

In the typical American fashion, this opportunity for the rewarding use of funds has encouraged a variety of financial institutions to enter the field of consumer lending. Commercial banks have always taken care of a portion of this market, but in relatively recent times some banks have sharply expanded their holdings of consumer paper by opening consumer loan departments or purchasing consumer paper generated by retail sellers of durables.

An additional major share of consumer credit

has come to be extended by sales finance and personal finance companies, specializing in offering loan contracts tailored to particular types of consumer expenditure.

Other institutions have developed which both lend to and borrow from consumers, providing an outlet for personal savings as well as a source for certain types of personal financing. In this category are mutual savings banks, savings and loan associations and, to a lesser extent, life insurance companies, which direct all or an important part of the savings they receive into the financing of the most durable of consumer purchases, housing. Also included in this group are the most numerous and fastest growing of all savings institutions, the credit unions. The aggregate savings lodged in credit unions are but a tiny fraction of the total invested in the other financial institutions mentioned. Credit

union assets are less than one-tenth of the total for mutual savings banks or savings and loan associations; they make less than 7 per cent of total consumer instalment credit; and even in the field of their specialty, the instalment cash loan, credit unions hold only 17 per cent of the national aggregate. But the current strength of their appeal may be illustrated by the fact that, in the last year alone, 1,500 new credit unions were formed and total credit union assets grew by 11 per cent.

Savings appeal

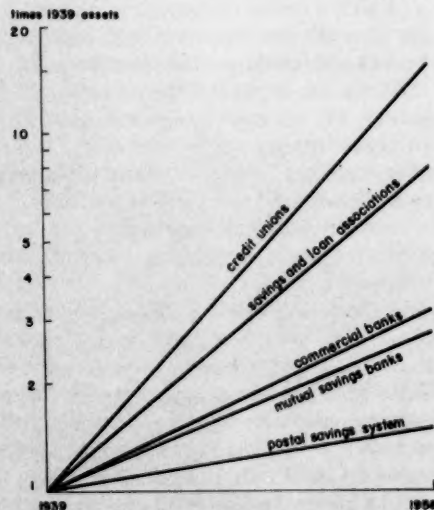
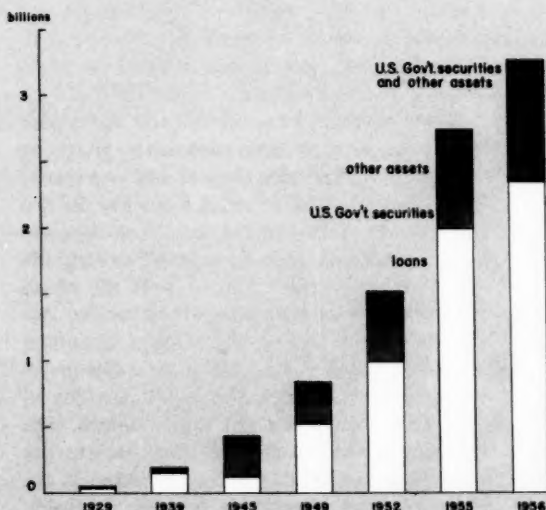
Several factors account for the recent gains in credit union assets. One reason is that many credit unions have paid dividends on members' savings of between 3 and 5 per cent per annum, which compares favorably with the return from bank time deposits and savings and loan shares. The typically convenient location of the credit union office has invited savings. The weekly deposit of a few dollars has been encouraged in some industrial plants by having the credit union office next to the paymaster's window.

Also through payroll deduction plans, many industrial credit unions have regularized members' savings and have made loan repayments a routine procedure. Paradoxically, the lending facilities themselves may also encourage saving, because of the acquaintanceship with credit union operation which a borrower gains.

Credit unions, in addition, perform a number of other services for members, such as cashing payroll checks and furnishing advice on family budgeting. The low-cost life insurance which most credit unions provide in an amount generally equivalent to members' shareholdings and loan balances induces older members, especially, to borrow rather than liquidate their savings when in temporary need of cash. And, of course, the general prosperity of the nation and the high rate of saving have also contributed to the expansion of credit union assets.

The credit union movement was introduced in America about fifty years ago, largely in response to the belief that the low-income populace could improve on the financial facilities available to them by pooling their savings and

Credit union assets have steadily increased . . . and now are 16 times the prewar figure



lending to each other. Such lending was expected ordinarily to be in modest amounts and for necessitous purposes. In order to have a community in which members would know other members and lending could be done largely on the basis of character, membership in each credit union was restricted to persons having a well-defined mutual bond, such as work or worship or residence in a common place.

While in the early years, credit unions were envisioned as appealing equally to neighborhood, church, fraternal and employee groups, today three out of four credit unions serve occupational groups. This is so partly because plant managers who want to avoid the problems and clerical expense involved in processing salary advances and wage garnishments have encouraged workers who need cash to borrow from "company" credit unions.

Credit unions are most numerous, therefore, in industrial states. Of the nation's 17,500 credit unions at the end of 1956, Illinois leads with 1,466, followed by California with 1,439 and New York with 1,010. Assets are even more concentrated. Five states — California, Illinois, Michigan, Ohio and Massachusetts — account for about half the assets of all credit unions.

Four of the five Seventh District states are among the nation's first 15 in credit union assets. Illinois is second; Michigan ranks third; Wisconsin, ninth; and Indiana, eleventh. The rapidity of credit union growth is especially outstanding in Michigan, where aggregate credit union assets have grown in ten years from 21 million to 224 million dollars.

Credit unions operate either under state or Federal charter. Since 1909, when the Massachusetts law was passed, 44 states and the District of Columbia have enacted enabling legislation. Credit unions may be chartered in any state or territory under the Federal Credit Union Act of 1934. While state credit unions are under the supervision of state authorities, Federal credit unions are examined by employees of the Bureau of Federal Credit Unions, an agency which is at present part of the Department of Health, Education and Welfare.

Members purchase shares which are recorded,

along with any repayments, in pass books. In some states deposits are also accepted. The accumulated saving of members thus forms the credit union's capital. Similar to savings and loan shares, members receive dividends from net earnings rather than interest. And in practice, shares, unless pledged as security for a loan, can be redeemed, or deposits withdrawn, on demand. Credit unions, like savings banks and savings and loan associations, may require a 60-day, usually written, notice of withdrawal. Thereafter, if withdrawal requests cannot be honored, business is suspended. If the credit union cannot work out the situation, there is finally a general scale-down of share values or liquidation.

Low cost loans

The laws regulating credit unions vary somewhat, but differences have lessened over the years and are now for the most part confined to the amount of money that can be loaned under various conditions. The Federal Credit Union Act, under whose provisions about one-half of all credit unions operate, specifies that all loans in excess of 400 dollars must be secured. Furthermore, secured loans may not exceed 10 per cent of the credit union's unimpaired capital and surplus. The maturity on any loan may not be more than three years, though contracts are often renewed or extended prior to maturity. The interest rate charged may not exceed 1 per cent per month on the unpaid balance of the loan, including servicing charges. This rate of interest approximates bank charges, and it is considerably less than the rate on many finance company loans. In some cases, the effective rate is even lower, since if earnings are good, the credit union, following the cooperative principle of serving both saver and borrower, may refund a portion of the interest paid by the borrower.

For much of the history of the movement, the focal point of credit union operations and literature has been the small, emergency-type loan. In line with the national trend toward increased instalment buying, however, a growing proportion of the loan activity of credit unions has involved the financing of purchases of dura-

ble goods. Information from 1950 Regulation W reports indicated that, of outstanding credit union loans, 63 per cent were for personal uses, while 26 per cent were for automobile purchases, 6 per cent to finance other retail purchases, and 5 per cent to meet repair and modernization costs. Five years later, in 1955, the share of credit union loans for personal purposes was down to 59 per cent. With the growing concentration of credit union assets in larger credit unions, which do a substantial amount of automobile financing, instalment loans to finance retail purchases appear likely to continue to be a rising share of total loans.

Majority rule

Most credit unions are managed by a board of directors, a credit committee which approves loan applications and a supervisory committee which examines the books. All such officials are elected by the members at an annual meeting. Each member has one vote, irrespective of the size of his investment in the credit union. In contrast to savings and loan associations, no proxy voting is allowed.

At the annual meeting, the members also authorize the dividend rate and the interest refund. In 1955, 13 per cent of Federal credit unions paid no dividends, while 63 per cent paid dividends on shares of between 3 and 5 per cent.

With the exception of the treasurer, credit union officers must serve without pay. Volunteer managerial help, and in some cases also volunteer clerical help, negligible advertising costs and office space often donated by the

sponsoring organization keep expenditures low. This, in turn, helps to make possible the low interest charges on loans. Also, since credit unions are nonprofit organizations, they do not pay Federal income taxes, only local property and some state taxes, and social security.

The democratic organization of credit unions in some respects contributes to, and in other respects curtails, growth. Since the credit union charter specifies the field of membership, each credit union has a limited number of potential members. Equality in voting, undoubtedly, attracts some. But as growing credit unions have lost the neighborly intimacy of the small group, it has been increasingly difficult to enlist as officers capable persons who are willing to give, without salary, the time, energy and dedication which administering a large credit union requires. Moreover, since officers are elected as much on the basis of personal popularity as competence, mistakes occur. Recent Congressional hearings have been concerned with embezzlement and mismanagement, which is not serious now, but which looms in the background as individual credit unions accumulate large sums. In recognition of the responsibilities involved, the training of personnel for managerial positions has become an important part of the program of individual state credit union leagues and the Credit Union National Association.

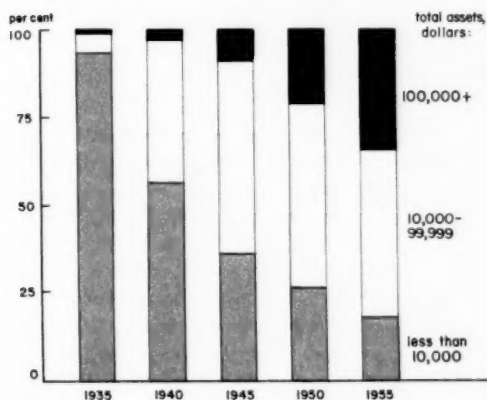
Portfolio considerations

At the end of 1956, loans represented 72 per cent of total credit union assets. This figure has been climbing gradually in the postwar period, and now is within the range of ratios of loans to assets which was common before the war. Aside from loans, most credit unions can legally invest only in U. S. Government securities, savings and loan shares and, in small restricted amounts, in shares of other credit unions. For big credit unions having more funds than are currently demanded, savings and loan shares have become the most popular residual earning asset. Federal credit unions' holdings of savings and loan shares at the end of 1955 (the latest year for which full statistics are available) were

Number, shareholdings and membership of credit unions have increased

	Number	Average shares per member (dollars)	Average membership per credit union
1949	9,897	171	413
1952	12,249	222	481
1955	16,050	292	508
1956	17,500	315	509

The typical association is now much larger than in 1935



twice their U. S. Government securities holdings.

Portfolio composition, of course, varies among individual credit unions. Size and age, especially, have a decisive influence on asset distribution. Young and small credit unions tend to have more loans and fewer U.S. Government securities.

Credit union members are constantly purchasing shares and making loan repayments. But credit union receipts may sometimes fall short of disbursements for a period. For example, in emergency situations such as a strike, numerous members may default in their loan payments or may make heavy withdrawals. Hence credit unions must have sufficient cash, credit lines and short-term securities which can readily be converted into cash to provide a safe margin for operating expenses and withdrawals.

Among individual credit unions there is wide variation in the ratio of cash and U.S. Government securities to share capital, but for all credit unions together this ratio stands now at about 20 per cent. Credit unions may, of course, meet heavy cash drains by borrowing from banks or other credit unions. At the end of 1955, notes payable of Federal credit unions amounted to 29 million dollars, 2.3 per cent of

assets. During 1956, credit union borrowings probably increased further, in repetition of the 1955 pattern. Such trends have helped to stimulate a great deal of discussion, both pro and con, regarding the need for rediscount agencies where member credit unions could borrow in periods of financial stress.

Savings not insured

Another point of controversy in credit union circles has been the question of share insurance. Shareholdings in Federal or state credit unions are not now insured by any government agency, although President Eisenhower in both his 1955 and 1956 *Economic Report* recommended to Congress that they "consider the merits of share-account insurance and other measures for protecting savings in credit unions." In Illinois the legislature has enacted a law which permits a private corporation to guarantee shares of credit union depositors up to \$10,000. Twenty per cent of credit unions in Illinois now have guaranty coverage. Some other states have voluntary insurance plans administered by state credit union leagues. Opponents of share insurance cite the record that credit union losses on bad loans have amounted to less than 1/4 of 1 per cent of money loaned and that losses are covered by reserves which each credit union is required to maintain. Moreover, in liquidation, they add, most credit unions have been able to pay their members 100 per cent or more of their shareholdings.

Other than in wartime, reasons for liquidation of individual credit unions have included plant shutdowns, company mergers, insufficient membership, lack of competent management and company hostility. Support for insurance has come mainly from large credit unions that fear the "runs" which can result from defalcations and lay-offs and the costs and delays in loan collection when a plant has closed and workers have dispersed.

The constraints of growth

The remarkable rate of growth of credit unions is undeniable evidence of their appeal as a savings institution and of their expanding

role in financing consumers. Yet there are limits to the growth of individual credit unions in their conventional form. They are set on the savings side by the size of the group served, and they may be inferred on the lending side from the relatively slow national growth of instalment cash loans from all sources combined.

In practical operation, these limits may be stretched by measures such as paying higher dividends and diversifying loan services into areas of relatively expanding credit use. But such practices lead away from the initial aims

of the credit union movement, and the results they produce can tend to dilute the intimate credit union member relationship.

In the climate generated by these changes, it becomes harder to nurture a reformist zeal for ministering at low cost to the necessitous requests of workers of modest means. One gratifying economic implication should not be overlooked: that the financially underprivileged worker of yesteryear is being succeeded by a more knowledgeable and resourceful generation with a significantly wider horizon of financial opportunities in view.

Our economy *continued from page 6*

exist in a society run by tradition or the rule of authority. For, in the market system, the lure of gain, not the pull of tradition nor the whip of authority, steers each man to his task. And yet, although each may go wherever he thinks fortune beckons, the interplay of one man in competition with another results in the necessary tasks of society getting done.

Now we know from our experience that the functioning of markets is not always good. Markets can, in fact, function very badly, particularly when they are dominated by monopoly, by speculative excesses or by inflationary forces. Those of us who are truly concerned with utilizing the resources of the market must devote our energies to the promotion of competition, the restraint of speculative excess and the maintenance of the stability of the dollar.

It seems obvious that the market system could not function without money, for money is at the heart and center of a flexible society. No modern country can have stability and progress without some basis of sound currency. That is why all modern countries have central banks. That is why the United States has the Federal Reserve System.

Money performs a great many services for mankind, but none more important than in providing a degree of freedom that man could not attain if money did not exist. The bonds of

serfdom that once bound the mass of men for life to their native plot of soil and their native status in society were broken when payment in produce was supplanted by payment in cash.

Money gave men freedom of movement and leisure. It gave them the ability to change the nature and locality of their possessions and earnings at will. It gave them freedom to do as they please with the product of their labors — to eat it or drink it, to give it to a church or charity, or spend it for learning something, to save its value against some unforeseen event, to use it to lift living standards for themselves and their families or to put it aside to fortify their independence when they wish to assert it.

In short, money can be an instrument of freedom — if only we permit it to function in that role. But the power over money can also be an instrument of tyranny — witness the coin clipping by kings, a form of tyranny known at first hand by many of those who settled early in America. That is one of the reasons why there has been so much concern over monetary policy and monetary actions throughout our history.

When the first Bank of the United States was established under Government charter, great effort was put into preventing the Government, or political authority, from having any say over the bank and thus having a chance to indulge in coin clipping.

Gradually, as time went on, apprehension arose about too much private control over money. When the Second Bank of the United States was formed, there was some recognition that the public interest should be represented in the bank's setup. So, the Congress made provision for public representation when it granted the bank's charter.

But to Andrew Jackson, and many others as well, it seemed that the public representation permitted was not enough. It was not that Jackson opposed the idea of any central bank, for he said in his veto message that such an institution "is in many respects convenient for the Government and useful to the people." What he objected to was that this particular bank, as it was set up, provided private interests with what was, in the words of his veto message, "a monopoly — an exclusive privilege of banking . . . granted at the expense of the public." In consequence, Jackson destroyed the bank.

The enactment of the Federal Reserve Act, as part of Woodrow Wilson's "New Freedom," marked the beginning of what we might call modern times with respect to the role of Government in monetary affairs. Jackson's complaint had been answered: there would not be private domination of money — nor political domination either.

Let us not, however, be misled into thinking that the entrustment of money management to the Federal Reserve represents a change in fundamentals or an unawareness of the economic facts of life or a denial of the ability and courage of individuals as an essential part of the mechanics by which a higher standard of living is to be achieved.

At the center of our way of life always remains the market place, tying together individual freedom and material progress. While concepts may be modified, and should be from time to time, our basic thinking continues to recognize private property, free competitive enterprise and the wage and profit motive, operating in the open market through the price mechanism, as the most effective means of developing and sustaining our march toward

better living standards and the elimination of poverty.

Nothing in the background or history of the Federal Reserve Act indicates any misunderstanding of the law of supply and demand, or any belief that a Federal Reserve System could control or successfully manipulate, for long, supply and demand forces. Certainly the history of the past 40 years indicates the wisdom of this approach and demonstrates again that you can change the nature of demand and alter the composition of supply, but you can no more abolish the law of supply and demand than you can abolish the law of gravity. It must be reckoned with always, sooner or later, and, whenever we ignore the working of the market, we do it at our peril and ultimately must pay the piper.

Six years ago a decision to unpeg the Government securities market was in process of being carried into effect. For a number of years, efforts had been made to adjust the supply-demand relationships in Government securities without resorting to the price mechanism.

It had become quite popular in that period to assume that neither interest rates nor exchange rates made any difference, and that notions that they did matter were the fetishes of outmoded classical economists whose views were completely out of tune with the modern, postwar world. Then we saw reality creep up on us, a seller's market change to a buyer's market, and rates could no longer be pegged at artificial levels. The devaluations of the 1949 period, brought to head in September by the readjustment of the British pound sterling, were casting their shadows before and indicating that it might not be long before the supply-demand relationship in our Government securities market would have to be faced squarely unless we were willing to accept the alternative of drastic depreciation of the dollar.

Essentially, the Treasury-Federal Reserve accord returned to the market some of the influence which had been denied it by conscious Government policy for a period of more than 10 years. Once Government securities ceased to be interest-bearing money, and supply-de-

mand relationships began to be equalized by adjustment in interest rates, the credit mechanism once again began to operate through the market place.

The Federal Reserve System ceased to be an engine of inflation. It would still be that if it were to pour out money in the endless stream that would be necessary to supply reserves in sufficient volume to meet every demand for credit without an increase in interest rates, the price of money.

No one should expect the Federal Reserve to do that, for to do so would be an abandonment of the System's duty to keep the flow of credit in line with the resources of the economy so that we may continue in the path of stability and growth. Neither should anyone fear that credit will become "unavailable at any price." Fundamentally, the so-called "tight money" situation that has evoked so much comment has not been brought about by a reduction in the money supply. The money supply has not in fact been reduced. Actually, the money supply has increased, and so has its velocity or turnover. Credit has not been tightened by an insufficiency of money; rather, the tightening effect has been produced by the magnitude and intensity of demands for credit from practically all quarters. All of the demands could have been satisfied only by creation of more bank credit — creation of more money — and that, of course, would be inflationary.

But the problem of achieving a balance is not insoluble. In an economy as strong as ours, it can be solved in large measure by a reduction in spending and an increase in saving brought about by market forces.

The rediscovery of monetary policy in this country and throughout the free world dramatically illustrates the traditionally American recognition of the superiority of judgments arrived at in the market place to those made by individuals, or groups of individuals, within either Government or private business. It is my conviction that, by and large and excepting periods of war, you will get more impersonal, fairer distribution of our economic production through the process of the market than you will

by leaving the distribution to any group of men, whether in the Federal Reserve or elsewhere. Furthermore, the workings of the market will create a greater end product to distribute than any other system as yet devised.

The background of the American Revolution is so well known that every school-boy understands, in an emotional sense if no other, the guarantees of the First Amendment to our Constitution. Freedom of religion, freedom of speech, freedom of the press, freedom of the right to assemble and petition — all of them strike answering chords in the hearts of most Americans. Yet it has also seemed to me that the inter-weaving of these concepts in the fabric of our society, in terms of livelihood, is not so well understood. That is why I have spent so much time — perhaps too much — in reviewing our economic heritage.

We are a Republic, a constitutional democracy in which the general welfare is expressed in political procedures, forms and institutions. At the base of our structure lie certain principles and concepts, such as the market system, which are themselves the product of an evolutionary process.

In discussing these matters with you, I have been motivated by conviction that the problems we are dealing with today, and the road we hope to travel tomorrow, must be related to these principles and concepts if we are to have useful guideposts by which to keep our course steady in the murk and fog that from time to time surround us.

I have a deep and an abiding faith that the foundation on which our American economy rests is firm and sure. Our American economy is, indeed, the strength of our Republic.

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